Somewhat surprisingly, 45 percent of aid recipients in 1989 reported that they still paid more than 30 percent of their income for housing (see Summary Figure 2). That outcome is only partially explained by the nature of housing programs. Recipients of housing vouchers (one of the types of household-based aid) are allowed to spend more than 30 percent of their income for housing--and many do. Moreover, many recipients pay out of pocket for utility costs because the allowances for utilities that are not covered through the landlord in many instances fall short of the utilities' actual cost. However, in some cases the apparent high ratio of rent to income is probably the result of erroneous survey responses: some respondents to the survey CBO used to generate these statistics may have misunderstood the questions, underreported their income, or overstated their housing costs.

By contrast, virtually all households with priority and over 60 percent of other very low income renters paid more than 30 percent of their income for housing. Paying a large share of income for rent was, in fact, the only problem faced by the vast majority of eligible but unsubsidized households. An exception to this result was large families, for whom the large shares of their income spent for rent in many cases were insufficient to get them adequate housing.

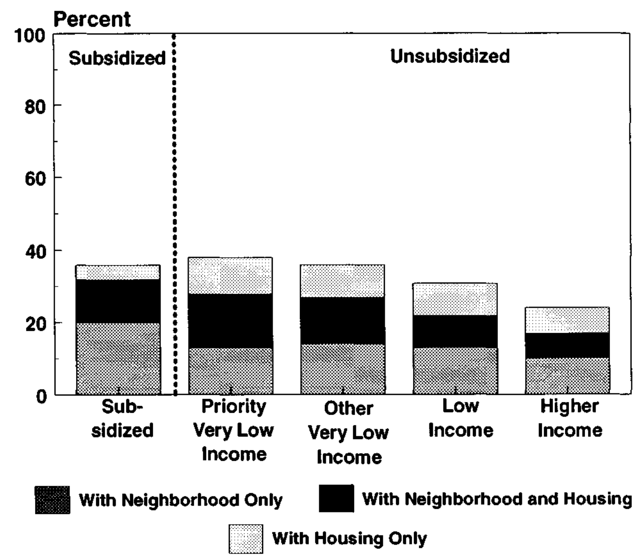
Housing aid reduced the incidence of inadequate housing among assisted households compared with unassisted ones with very low incomes. Overall, some 13 percent of subsidized households lived in substandard or crowded housing, less than half the share of unsubsidized very low income households that lived in such dwellings. But among large families, substandard or crowded housing was a major problem for both kinds of households. Over one-third of subsidized families with three or more children lived in inadequate units, as did more than half of their unsubsidized counterparts.

In terms of overall dissatisfaction with the conditions of their housing or their neighborhoods, very low income renters were similar, whether they received assistance or not (see Summary Figure 3). Altogether, about a third of both subsidized and unsubsidized households reported that either their housing unit or their neighborhood was unsatisfactory. In general, recipients of housing aid were relatively more likely than their unassisted counterparts to be satisfied with their units, but for assisted families with children, those units were more likely to be in unsatisfactory neighborhoods. Roughly 45 percent of that group reported dissatisfaction with their neighborhood, compared with about one-third of their unsubsidized counterparts.

Are There Differences in the Problems Faced by Recipients of Different Types of Housing Aid?

The majority of federal housing assistance today is provided in the form of project-based aid. But the current trend in new commitments of aid is toward greater use of household-based assistance, which households can use to rent units of their own choos-

Summary Figure 3.
Percentage of Subsidized and Unsubsidized Renters Dissatisfied with Their Neighborhoods or Housing Conditions, by Priority for Housing Assistance, 1989



SOURCE: Congressional Budget Office based on data from a special version of the 1989 American Housing Survey.

NOTES: See Box 3 in Chapter 3 for definitions of household groups and their priority status.

The data exclude renters who paid no cash rent.

ing from the nation's stock of privately owned housing. Household-based aid is considerably less costly to provide in the long run. In addition, it is portable and thought to be more effective in integrating low-income households into economically diverse neighborhoods. In tight housing markets, however, some households (especially large families) may have difficulty finding suitable units in the private rental stock.

The evidence is mixed on the incidence of problems faced by recipients of the two types of aid. Within each of the four demographic groups considered in this analysis, the incidence of substandard or crowded housing differed little between recipients of the two types of aid. By contrast, the recipients of project-based aid were generally much more likely than their counterparts who received household-based aid to report dissatisfaction with their neighborhood or their housing unit. The exception to that pattern was the elderly: those with project-based subsidies appeared somewhat less likely to be dissatisfied with their units than their counterparts with household-based subsidies.

Implications for Federal Housing Policies

Given the small share of eligible households that receive federal housing aid and the increasing competition for federal aid dollars, housing policymakers face two recurring questions. First, is the available aid now targeted toward those who are most in need? Second, could existing aid be reallocated to include more unassisted renters who need help? Much broader options could be considered in the context of a fundamental restructuring of the nation's welfare system. However, they are beyond the scope of this study.

Retargeting Federal Aid

Although housing aid is successful in reducing the incidence of certain housing problems, it is not necessarily targeted toward groups with the lowest incomes or groups with the highest prevalence of problems. The average income of aid recipients, though low, is considerably higher than the average income of nonrecipients with priority in all four demographic groups. In addition, a disproportionate share of all aid goes to elderly households. Yet housing and neighborhood problems are widespread among unsubsidized eligible families with children. Moreover, using a large ratio of rent to income to determine priority for aid gives preference to households that may have voluntarily chosen to rent relatively expensive but otherwise problem-free housing units. In effect, the current criteria penalize households that make ends meet by renting inexpensive units that are somewhat inadequate in quality or size, or located in undesirable neighborhoods.

The basic mechanisms for retargeting aid to new recipients would be to modify the criteria used to define the priority group of nonrecipients or to rearrange the rankings of subgroups within it. Definitions of the criteria that are currently used--namely, level of income, rent-to-income ratio, and quality of the housing unit--could be changed, or new criteria such as crowding or characteristics of the neighborhood could be added.

Nonetheless, shifting the current distribution of aid would not be an easy task. Directing more of the assistance toward a group of households that were poorer or that needed larger, and thus more expensive, housing units would raise expenditures per recipient. Increasing the proportion of aid going to families with children would have additional complications. In particular, much of the aid that elderly households currently receive is tied to small units in projects specifically constructed for them. Those units would not be suitable for families with children.

Helping More Unassisted Renters

Expanding the number of recipients of aid without increasing program costs would involve limiting the aid given to each household or using less expensive forms of housing assistance.

The federal government could reduce the subsidy per household in several ways. The large share of unaided households that now pay substantially more than 30 percent of their income in rent suggests that the government could require tenants in housing programs to contribute more toward their rent--for example, 35 percent of their income rather than the current 30 percent. Arguing against that option is the potential benefit of larger subsidies: concentrating limited federal resources on fewer families would enable them to make different choices that might help to improve their economic circumstances and eventually eliminate their need for federal assistance.

Lowering the maximum rents that the government subsidizes in household-based programs would also reduce the subsidies going to some assisted households. In contrast to the previous option, households could avoid paying more than 30 percent of their income for rent by living in housing units with rents below the new maximum. However, that option would generally decrease the number of housing units that those recipients could choose from. The exception is recipients with vouchers, who could choose the same units by paying more than 30 percent of their income in rent.

Yet another method to reduce the subsidy given to a particular household would be to limit the amount of time that a household could receive assistance. Not only do aid recipients now receive significant subsidies each year, but many assisted households continue to receive benefits over long periods. Limiting the duration of aid would allow available funds to be spread among a greater number of households with housing problems. But some households that were unable to better their economic situation within the time limit would either have to move or face a significant reduction in the income they had available for items other than housing.

Using less expensive forms of housing assistance could involve letting project-based subsidies expire and replacing them with household-based ones. Available information indicates that rents for certain housing units with project-based subsidies exceed by 35 percent the maximum rent that the government subsidizes in its household-based programs. Moreover, the evidence presented in this analysis suggests that with the exception of the elderly, recipients of household-based aid are less likely than recipients of project-based aid to be dissatisfied with their housing units or the condition of their neighborhoods. That pattern is apparent even though the incidence of substandard and crowded units is roughly the same for both types of aid among households of the same type.

Nevertheless, replacing project-based aid with household-based aid could mean the loss of a large number of housing units dedicated to low-income use. That loss could lead in turn to the displacement of the units' current occupants. And even if household-based aid was provided to them, some might have difficulty finding private landlords who were willing to participate in government programs.

Chapter One

Introduction

For more than half a century, the federal government has used a variety of approaches to provide housing assistance to renters with low incomes. Unlike federal entitlement programs, aid has never been provided to all of the households that qualify for it. Indeed, federal housing programs serve only a relatively small share of the households that are eligible.

Many households that do not receive subsidies but are eligible for assistance on the basis of their level of income face significant housing problems. More than half pay at least 50 percent of their income for housing or live in severely substandard or crowded dwellings. And subsidies do not necessarily guarantee complete relief. A sizable fraction of subsidized households also experience housing problems, even though housing assistance is specifically designed to reduce housing costs and improve housing quality.

The number of households that receive rental aid has risen steadily over the years. But efforts to continue that trend have been constrained recently by stringent limitations on federal discretionary spending and, increasingly, by competition for funds within the housing area itself. More and more resources are being channeled away from expanding the number of assisted households. In part, those funds now go to maintain the government's existing commitments to provide assistance and the quality of the stock of assisted rental housing.

These developments, coupled with broader interest in comprehensive reform of the nation's welfare system, may make this an opportune time to reassess the effectiveness of the current system in dealing with the housing needs of renters with low incomes. Particular questions to consider include whether the present system is helping the households that need assistance the most and whether there are ways to help more households with the same or a smaller amount of federal resources.

This study examines such topics from the viewpoint of reshaping federal policies for rental aid for the rest of the 1990s and beyond. It considers the scope of the major federal efforts to address the nation's housing needs and explores the growing "squeeze" on available funding to increase the number of renters receiving aid. It examines how and why the cost of rental housing has changed relative to renters' incomes over the past 20 years, resulting in what some people call a growing "affordability problem" for lower-income renters (see Chapter 2). The study also delves into the characteristics of federally subsidized renters and their housing and neighborhood conditions, as well as the characteristics and conditions of their unsubsidized counterparts who are eligible for aid--all key data for any reassessment effort (see Chapter 3). The Congressional Budget Office (CBO) based that part of the analysis on a specially constructed, confidential database that provides a unique perspective on the circumstances of subsidized and unsubsidized low-income renters. The final chapter discusses some of the implications of CBO's findings for federal policy.

Current Federal Approaches to Housing Aid

The federal government provides housing subsidies to both homeowners and renters. Those subsidies may be direct--that is, provided through federal spending programs. Or they may be indirect--provided through mechanisms such as provisions of the tax code and federal activities in the mortgage credit and insurance markets.

The principal goals of the direct spending programs have typically been to improve the quality of housing for renters and homeowners with low incomes and to reduce their housing costs. Other purposes have included expanding the housing options of groups with special needs such as the disabled, stimulating residential construction, promoting the preservation and revitalization of urban neighborhoods, and increasing the number of low-income homeowners. None of these programs have ever been provided as entitlements.

The focus of indirect federal support has predominantly been to increase home ownership. The beneficiaries of that kind of aid typically are better off financially than the people who benefit from direct expenditures. Moreover, it is generally available to anyone who meets the eligibility requirements.

Aid to Homeowners

By far the largest source of federal support for housing is the provisions in the tax code that lower the after-tax cost of home ownership and reduce the taxes that owners must pay when they sell their homes for a profit. Those types of support go mostly to middle- and upper-income homeowners. As a whole, the so-called tax expenditures for those purposes totaled an estimated $86 billion in fiscal year 1994. (All dollar amounts in this chapter are expressed in 1994 dollars unless noted otherwise.)

The federal government also helps moderate-income households to become homeowners by funding various mortgage insurance and mortgage guarantee programs. In fiscal year 1994, the Federal Housing Administration (FHA) insured an estimated $70 billion in new loans covering over 900,000 units. The Department of Veterans Affairs (VA) guaranteed an estimated $28 billion in new mortgages for nearly 300,000 veterans. Those activities create substantial contingent liabilities for the government--that is, liabilities that the government must make good on in the event of a default by the borrower. At the end of fiscal year 1994, the government's contingent liability for all outstanding mortgages of the FHA and the VA combined amounted to more than $400 billion.

Mortgages at below-market interest rates constitute another type of subsidy. This relatively modest amount of support goes to low-income homeowners, mostly through the Farmers Home Administration (FmHA) in rural areas. The FmHA supplies mortgage loans directly and also provides guarantees for loans made by private lenders. During fiscal year 1994, about 39,000 home buyers received $2.4 billion in new reduced-interest loans. The estimated cost of those subsidies over the length of the loans is $345 million. Those costs include subsidies for the lower rate of interest and the costs associated with any future defaults. By the end of 1994, an estimated 750,000 homeowners in total were benefiting from these reduced-interest programs.

Aid to Renters

The federal government provides the lion's share of rental aid through direct spending programs. Subsidies from those programs primarily benefit renters with low incomes and constitute a much smaller share of federal housing efforts than subsidies for home ownership. The Department of Housing and Urban Development (HUD) administers the major rental assistance programs, which provide the bulk of rental aid and are the focus of this study. Spending by those programs amounted to an estimated $22 billion in 1994 and went to about 4.7 million households. The FmHA reduced rents for another 0.5 million rural renters.[1]

Rental assistance can be either project based or household based (see Box 1). Both types of aid typically reduce a household's payments for rent to about 30 percent of income, with the government paying the remaining amount.

The major HUD programs that provide project-based aid are the public housing program and the

1. Expenditures for the FmHA programs cannot be compared directly with those of HUD's programs because of different bookkeeping practices under credit reform.

Box 1.
Types of Rental Housing Assistance

Households receiving federal housing aid are divided into two groups: those that receive project-based subsidies and those that receive household-based subsidies.

Project-Based Subsidies. Households that receive this kind of subsidy must live in certain publicly or privately owned housing projects that have been constructed or rehabilitated under various programs administered by the Department of Housing and Urban Development (HUD). The main programs are the following:

- o *Public Housing.* Projects are built with federal funds but are owned and operated by local public housing authorities. Tenants typically pay 30 percent of their income for rent, and the federal government pays the remainder of the costs of operating the project.

- o *Section 8 New Construction and Substantial Rehabilitation.* In this program, private entities build and own the projects. The federal government, however, agrees to subsidize rents for periods ranging from 20 to 40 years. Tenants typically pay 30 percent of their income for rent; the federal government pays the remainder.

- o *Section 236.* Projects are built and owned by private entities, but the federal government supplies a variety of subsidies, including ones for mortgage interest, to keep rents affordable. Tenants may pay more or less than 30 percent of their income for rent, depending on their income and the particular type of subsidy that the project owner receives.

Household-Based Subsidies. Households that receive these subsidies may live in a unit of their choosing from among the stock of private rental units, provided that the unit meets HUD's standards for quality and occupancy. There are two kinds of household-based subsidies:

- o *Section 8 Certificates.* The federal government pays the difference between the unit's actual rent and 30 percent of the tenant's income. Generally, the rent for the unit may not exceed the fair market rent, which is set at roughly the 45th percentile of local rents (adjusted for the number of bedrooms) of units that have turned over in the past two years.

- o *Section 8 Vouchers.* The federal government pays the difference between a payment standard that is similar to the fair market rent and 30 percent of the tenant's income. If the actual rent exceeds or is less than the payment standard, the tenant pays the excess or keeps the difference.

Section 8 new construction and substantial rehabilitation program.[2] Because of high costs, the Congress has sharply curtailed the public housing program since 1983 and discontinued the Section 8 program, except for a small number of new commitments each year for units for elderly and disabled people. Nevertheless, because of the pattern of past funding, most people who receive federal rental aid today receive project-based subsidies.

Household-based aid is provided through the Section 8 certificate and voucher programs. One difference between these two types of programs is in the units that a recipient can rent with this assistance. A certificate recipient is generally limited to choosing from among units that rent for no more than the so-called fair market rent (FMR)--roughly the 45 percent mark, or "percentile," of the distribution of local rents of units that have turned over in the past two years. Voucher recipients face no such restrictions. Another difference is that certificate recipients receive no additional monetary benefits from choosing a unit that rents below the FMR. In contrast, voucher recipients who choose a unit that rents above or be-

2. For a more detailed discussion of federal housing assistance programs, see Congressional Budget Office, *Current Housing Problems and Possible Federal Responses* (December 1988).

low a payment standard (which is similar to the FMR) must pay or get to keep the difference between the actual rent and the standard. Since 1983, commitments for new aid have been primarily of the household-based kind.

Recently, the federal government has added some new approaches to reduce rents for people with low incomes. Those approaches include the low-income housing tax credit (LIHTC), which subsidizes the construction and rehabilitation of rental units through the tax system, and HUD's HOME Investment Partnerships program, which provides matching block grants to state and local governments to increase the supply and affordability of housing. Subsidies that those programs provide usually are not large enough by themselves to lower rents to 30 percent of a relatively poor household's income. The LIHTC program cost an estimated $2 billion in 1994. The HOME program received about $1.3 billion in 1994.

Recent Trends in Rental Housing Assistance

Traditionally, the Congress each year appropriates funds--as budget authority--for housing programs for two broad purposes: to fund new commitments to increase the number of assisted households and to support and renew existing commitments of aid. Funds for the first purpose are known as incremental aid; funds for the second are called nonincremental aid. Nonincremental aid extends the life of existing aid commitments, maintains or restores the quality of existing structures, or increases aid to current recipients.

A given year's appropriation of budget authority for housing gives rise to expenditures, called outlays, that generally occur over many years. In some housing programs, including all variants of the Section 8 programs, budget authority allows the government to make subsidy payments on behalf of households over periods that today range from 5 to 20 years. (Before 1983, those periods were as long as 40 years.) When those commitments expire, the Congress must appropriate new budget authority if aid is to be extended for subsequent years. (Figure 1 illustrates those patterns.)

In other housing programs, such as public housing, the Congress appropriates budget authority for grants to entities that construct and rehabilitate assisted rental housing. The outlays resulting from those grants also occur over a number of years because of lags in construction and rehabilitation. After construction is finished, additional budget authority may be needed each year to help pay for the operating expenses of the project (see Figure 1).

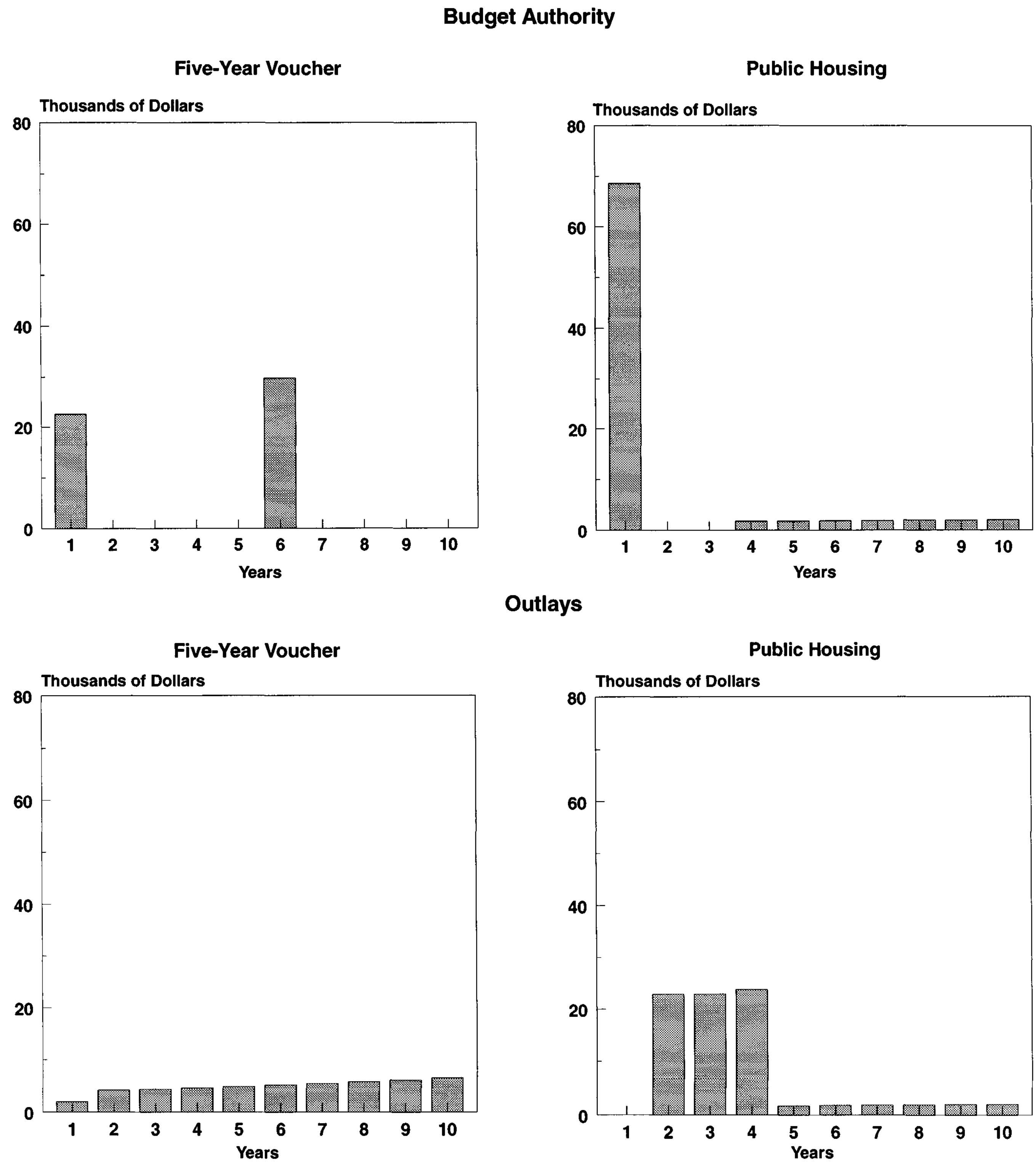
This pattern of long-term spending gives rise to a complicated relationship between the total number of assisted housing units, the outlays that support them, and the budget authority that creates them. It helps explain the apparently contradictory movements since 1977 of growth in the number of assisted households and outlays on the one hand and a decline in budget authority on the other.

Rising Numbers of Assisted Households and Outlays

Both the number of households that receive rental aid and the federal outlays for those subsidies have increased almost every year since 1977. The number of assisted households almost doubled between 1977 and 1994, rising from 2.4 million to 4.7 million (see Figure 2). Growth was generally more rapid during the first half of the period than during the second, however, because lower annual appropriations during the 1980s, among other things, sharply decreased the number of additional new commitments.

Outlays for rental assistance generally have also increased steadily since 1977. Real outlays (adjusted for inflation) more than tripled between 1977 and 1994, rising from $6.6 billion to over $22 billion (see Figure 3). That relatively rapid growth is due not only to increases in the number of assisted households but also to several factors that have raised the average real subsidy per assisted household. For example, during the early to mid-1980s, many newly constructed Section 8 units became occupied. Those units, funded from pre-1982 budget authority, required large rental subsidies, which contributed to the

Figure 1.
Illustrative Patterns in Budget Authority and Outlays to Provide Housing Aid to One Household for 10 Years Through a Voucher or by Building a Public Housing Unit



SOURCE: Congressional Budget Office.

NOTE: The figure is illustrative only. It is not meant to present the relative costs of the two programs.

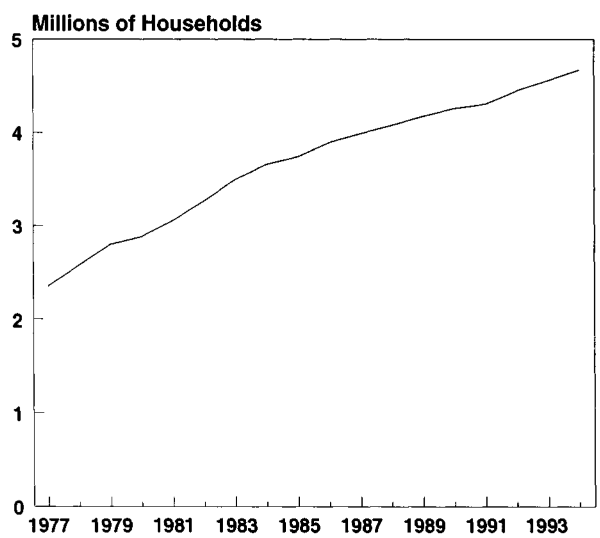
relatively high rate of growth in outlays during that period. In addition, the average rent in assisted units grew faster than tenants' incomes. That growth pushed up federal subsidies, which typically equal the difference between a unit's rent and 30 percent of the tenant's income.

Declining Annual Appropriations of Budget Authority

In contrast to outlays, annual budget authority for housing aid has decreased sharply in real terms since the late 1970s, when several new housing programs were first funded. Real budget authority fell from $69 billion in 1977 to $10 billion in 1989 (see Figure 4). Since 1989, however, the trend has changed: budget authority rose to $21 billion in 1992 and has remained fairly flat since then. For 1995, the Congress appropriated $17 billion.

As noted earlier, a major component of the decrease in budget authority during the 1980s was the decline in the number of additional new commitments funded each year--from more than 300,000 per year in the late 1970s to fewer than 60,000 by 1991 (see Figure 5). Other components of the decline in budget authority--which did not affect the number of assisted units--included a shift toward shorter commitments, cheaper forms of aid (by using existing housing rather than new construction), and, since 1987, changes in the method of financing new construction and modernization programs.[3] For ex-

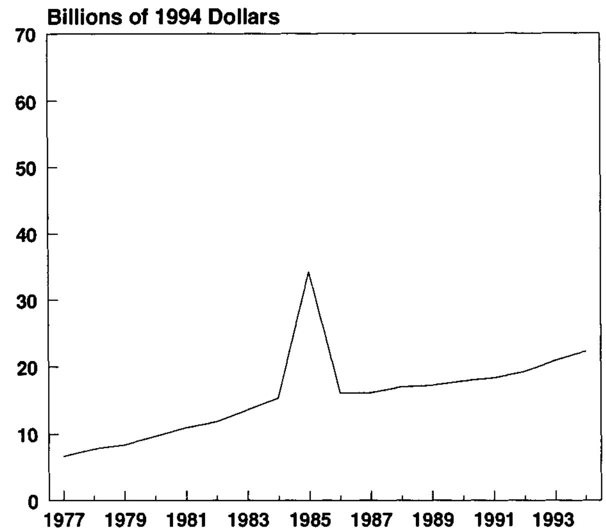
Figure 2.
Number of Households Receiving Rental Housing Aid, End of Fiscal Years 1977-1994



SOURCE: Congressional Budget Office based on budget documents of the Department of Housing and Urban Development.

NOTE: Figures for 1992 and 1994 are estimated.

Figure 3.
Outlays for Rental Housing Aid, Fiscal Years 1977-1994



SOURCE: Congressional Budget Office based on budget documents of the Department of Housing and Urban Development.

NOTES: The bulge in outlays in 1985 resulted from a change in the method of financing public housing that generated nearly $14 billion in one-time expenditures. Because of those expenditures, outlays for public housing since 1985 have been roughly $1.4 billion (in nominal dollars) lower each year than they would otherwise have been.

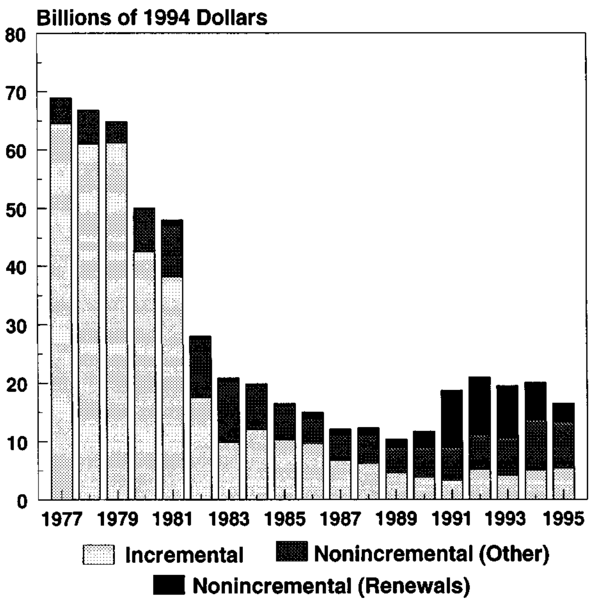
The figure for 1994 is estimated.

3. Before 1987, construction and modernization of public housing were financed over periods ranging from 20 to 40 years. Budget authority reflected principal and interest payments on that debt. Now those activities are financed with grants, which reduces the budget authority required by between 51 percent and 67 percent. In 1985, most of the outstanding debt incurred for public housing activities since 1974 was retired. That action caused the bulge in outlays shown in Figure 3 and has reduced outlays since that time by about $1.4 billion per year (in nominal terms). Similarly, before 1991, the construction of housing for elderly and disabled people was financed by direct federal loans coupled with 20-year Section 8 rental assistance, which helped repay those loans. Starting in 1991, grants replaced the loans, which reduced the amount of budget authority required for the rental assistance portion.

ample, reducing the length of commitments made under the Section 8 existing-housing program from 15 to 5 years decreased by about two-thirds the amount of budget authority needed in the short term to aid a given number of households. However, that budget authority must be renewed more frequently. As a result, the total resources required over the long term remain unchanged.

The overall decline in budget authority for housing aid and the relative growth of nonincremental aid have increasingly crowded out funds for additional commitments. For example, between 1985 and 1989, when real budget authority declined by 37 percent, nonincremental aid fell by only 6 percent, whereas incremental aid dropped by 55 percent. Since then, incremental aid has not changed much, but total budget authority has increased sharply, mostly because of the need to fund assistance commitments that are expiring.

Figure 4.
Budget Authority for Rental Housing Aid, by Type of Aid, Fiscal Years 1977-1995

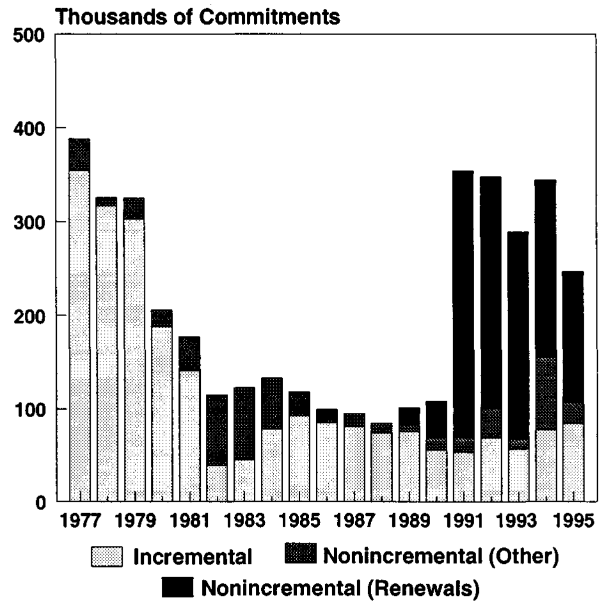


SOURCE: Congressional Budget Office based on budget documents of the Department of Housing and Urban Development.

NOTES: Incremental aid is aid that increases the number of assisted households. Nonincremental aid for renewals is aid that extends the life of current commitments of aid. It includes funding for amending contracts whose funds are exhausted before the end of the term of the contract. Other nonincremental aid includes, among other things, funding for aid tied to certain units that previously were assisted under a different program and funding for operating subsidies and modernization of public housing.

Figures for 1994 and 1995 are estimated.

Figure 5.
Annual Commitments of Rental Housing Aid, by Type, Fiscal Years 1977-1995



SOURCE: Congressional Budget Office based on budget documents of the Department of Housing and Urban Development.

NOTES: Commitments for any given year exclude housing units for which funds were deobligated, or canceled.

Incremental commitments increase the number of assisted households. Nonincremental commitments of aid for renewals extend the life of current aid commitments. Other nonincremental commitments include aid tied to certain units that previously were assisted under a different program.

Figures for 1994 and 1995 are estimated.

How Can the Trend in Outlays Be So Different from the Trend in Budget Authority?

The patterns in outlays and budget authority for rental aid diverge for several reasons. First, most outlays in any given year derive from past appropriations of budget authority. For example, throughout most of the 1980s, annual outlays grew despite decreases in budget authority because the funds appropriated in earlier years were being spent. (In fact, even if no budget authority had been appropriated, outlays would have continued to grow during that period as units funded with budget authority from previous years advanced through the processing pipeline and as average subsidies per assisted household increased.) But to the extent that the decreases in budget authority were associated with fewer additional commitments of aid, the drop in budget authority foreshadowed the ensuing decline in the rate of growth of outlays and the number of assisted households.

A second reason that outlays and budget authority did not necessarily move in tandem was the change in how budget authority was divided among incremental aid and the various types of nonincremental aid. Outlays grow over time when appropriations are for incremental aid--which, by definition, increases the number of assisted households--or for the type of nonincremental aid that increases the subsidy per assisted unit (such as aid for repairs to housing projects). Before 1989, for example, outlays were growing fast in spite of dropping budget authority because budget authority was mostly for incremental aid. By contrast, appropriations for the type of nonincremental aid that merely extends the life of existing commitments prevent the drop in outlays that would occur if those commitments expired and the total number of assisted households fell. If the Congress appropriated budget authority solely to extend existing commitments, outlays would remain fairly flat over time. Starting in 1991, a large share of the new appropriations has been designated for that purpose. Therefore, the sharp increases in budget authority since that time are not reflected in equally sharp increases in outlays.

Future Costs of Continuing Nonincremental Assistance

Many of the housing programs administered by HUD have now reached the point where they need additional funding if the Congress wants to preserve the number and quality of the rental units that those programs assist. Budget authority would be needed for several purposes: extending the life of assistance contracts that have started to expire, providing incentives to owners of certain assisted housing projects to prevent them from dropping out of the federal programs, disposing of projects whose owners have defaulted on their federally insured mortgages, continuing operating subsidies in the public housing program, and reducing large accumulated backlogs of repairs of the stock of aging assisted housing (see Table 1).

Extending Assistance Contracts

By far the largest demand for nonincremental aid is for renewing assistance contracts under the Section 8 program. Since 1989, those contracts, which were funded in past years for periods ranging from 5 to 40 years, have started to expire.[4] To maintain the number of outstanding commitments, the Congress has provided funds to renew the contracts expiring in each year between 1989 and 1993 for five years. The 1994 and 1995 appropriations, however, were about $1 billion and $2.6 billion short, respectively, of the amounts requested by the Administration to renew all expiring contracts for five years. As a result, many of the contracts that expired in 1994 have been renewed for only four years, and many of those expiring in 1995 will be renewed for three years.

The first year in which a large number of contracts expired was 1991, when $7.9 billion (in nominal terms) was needed to renew them for five years. During the 1991-1995 period, annual requirements are in about the same range. Starting in 1996, though, the annual budget authority required to extend contracts for five years is estimated to jump to a range of $14 billion to $18 billion (in nominal terms) as the first cohorts of renewed contracts expire again and other contracts expire for the first time. In 1998, because of the recent shortfall in appropriations for

4. Many contracts run out of money even before their terms expire because it is very difficult to estimate up front how much money will be needed to provide subsidies over the long terms that many of these contracts have. In such cases, the Congress appropriates funds for so-called amendments to the contracts, which support the commitments until their terms expire.

Table 1.
Estimated Cost of Preserving the Stock of Assisted Rental Housing, by Type of Program, End of Fiscal Year 1994 (In billions of 1995 dollars)

Type of Program	Unfunded Backlog	Annual Need	Remarks
Extending Section 8 Assistance Contracts	0	21.6	Annual needs reflect average budget authority to renew with five-year vouchers one-fifth of all current Section 8 contracts, once they expire.
Providing Incentives for Private Owners to Stay in a Housing Program	1.6	0.7	Backlog reflects estimated funding needed for incentives when projects first become eligible for them. Annual needs reflect average budget authority needed to renew for five years one-fifth of all new Section 8 contracts provided as incentives, once they expire.
Disposing of Units Owned by HUD	a	1.2	Annual needs reflect average budget authority for disposing of backlog of units in HUD's inventory and those estimated to come into the inventory through 1999.
Operating Subsidies for Public Housing	0	2.6	Annual needs reflect total budget authority for covering the difference between operating costs and rent collections.
Repairing the Assisted Stock			
Public Housing	10.5 to 20.7	2.2	Annual needs reflect average budget authority for performing repairs, once the backlog has been eliminated.
FHA-Insured Multifamily Housing	1.1	a	Backlog is adjusted for estimated repair needs of projects that are included in the second type of program listed above.

SOURCE: Congressional Budget Office based on published and unpublished data provided by the Department of Housing and Urban Development.

NOTE: HUD = Department of Housing and Urban Development; FHA = Federal Housing Administration.

a. Estimate not available.

renewals, four cohorts will expire simultaneously, requiring an estimated $29 billion (in nominal terms) for new contracts with five-year terms. Eventually, if no additional commitments were made for Section 8 assistance, the annual cost of renewing the roughly 3 million contracts in force today would amount, on average, to about $22 billion per year.[5]

The Omnibus Budget Reconciliation Act of 1993 (OBRA-93) limits both budget authority and outlays for programs that receive annual appropriations through the year 1998. The act has certain provisions to accommodate the large demands for budget authority that the housing programs will generate.[6]

5. These large amounts of budget authority would not increase the number of assisted households, however, and would therefore increase total real outlays for housing aid only to the extent that average subsidies per assisted household rose faster than inflation. Indeed, if the expiring contracts were not renewed, the number of assisted households--and therefore outlays--would decline sharply.

6. OBRA-93 stipulates how the baseline for renewing expiring contracts is to be estimated.

Nevertheless, the provisions do not guarantee that funds will be made available perpetually to renew all contracts for five-year terms. The shortfalls in appropriations for 1994 and 1995 are evidence of that lack of guarantee.

Incentives for Private Landlords

The federal government has recently taken steps to ensure that private entities that provide rental units through certain federal housing programs will keep their projects available and affordable to households with low incomes rather than convert the units into rentals at market rates. Thus, owners of roughly 400,000 rental units are, or soon will be, eligible to apply for financial incentives. Under those incentives, owners can raise the rents in their projects, but the federal government will provide subsidies to keep the units affordable to tenants. The additional assistance is considered nonincremental aid because it comes on top of subsidies that the owners already receive. That mechanism increases the average subsidy per assisted tenant without increasing the number of assisted units.

In 1993, HUD estimated that owners of only about 132,500 units would apply for these incentives. Consequently, it would need a total of $3.3 billion (in nominal terms) to fund the first round of incentives as owners became eligible for them.[7] So far, about half of that amount has been appropriated. Renewing those contracts when they expired would require additional funds. For example, HUD estimates that the first round of five-year renewals of all of those contracts would cost $3.9 billion (in nominal terms).

In its estimate, HUD assumed that owners of the remaining units that are (in principle) eligible for incentives would not apply for them. Incentives are based on the rents those units can command on the open market. But those rents were estimated to be so low at present that the projects would not qualify for any additional subsidies, or at best, only a small amount. The owners of those units could, however, apply for them at a later date, when market conditions became more favorable. In that case, the actual funding needed would be greater than current estimates indicate.

7. This estimate includes five-year budget authority for Section 8 assistance to an additional 66,000 tenants who are not currently receiving it, plus amendments to cover increased rents for the remaining term (on average, three years) of Section 8 assistance already in force.

Disposing of Units That Are Owned by HUD

The FHA insures or holds mortgages on more than 15,000 multifamily rental projects that serve over 1.8 million families. Most of those families have low incomes. HUD has committed billions of dollars in federal housing aid to roughly 70 percent of the units in those projects to help make them affordable to households with low incomes.

In some cases, HUD is forced to foreclose on a defaulted loan that was originally insured by the FHA. Once that occurs, it tries to sell the property. But the law requires HUD to preserve a number of units in certain projects as affordable housing, typically by providing assistance tied to some or all of the units in those projects. (The law stipulates the share of units that must be preserved for low-income use under various circumstances.) Because HUD lacks the funds necessary to provide the assistance required by law when it sells a property, it has been unable to dispose of many of the foreclosed projects. Consequently, they have become part of the so-called HUD-owned inventory.

Those properties now pose a growing problem for HUD. The department's inventory has grown from 10,000 units in 1990 to almost 76,000 units at the beginning of fiscal year 1994. Last year, HUD estimated that selling those units over the 1994-1999 period, plus another nearly 90,000 units that are expected to face foreclosure between 1994 and 1999, would require a total of $6.3 billion (in nominal terms) of budget authority, of which $5.2 billion remains to be appropriated.

Public Housing Operating Subsidies

Since 1969, the Congress has paid operating subsidies to public housing authorities on behalf of tenants living in projects built under the public housing program. Those subsidies pay the difference between the projects' operating costs and rent collections. Although rental aid under the Section 8 programs has always been funded through multiyear contracts, operating subsidies for public housing have been funded one year at a time. Continuing that form of aid for the 1.4 million tenants who live in public housing would require about $2.6 billion per year.

Repairing the Stock of Assisted Housing

A large portion of the projects that have federal rental subsidies tied to them are reaching the age where they need substantial repairs to maintain or restore their quality. Most of those projects are in the public housing program. Although they are owned and operated by local public housing agencies, they depend on federal funds to meet their repair needs. A fair share of privately owned projects also lack the funds to carry out needed repairs.

Public Housing. The public housing program has been in existence since 1937. Many projects now require major work to restore their quality. Despite annual appropriations of about $2 billion or more since 1987 that have been specifically designated for modernizing public housing, there is still a large unfunded backlog of needed repairs.

At the end of fiscal year 1995, that unfunded backlog is estimated to be between $10.5 billion and $20.7 billion, depending on what modernization work is included in the calculation.[8] (Those figures take into account the budget authority appropriated for 1995.) In addition to the backlog, new repair needs accumulate each year as the public housing projects age. Funds to perform those repairs are estimated at $2.2 billion per year for items deemed mandatory.

Multifamily Housing with Federally Insured Mortgages. In 1989, an estimated 55 percent of FHA-insured multifamily properties had insufficient funds in their reserve accounts to cover the backlog of repair and replacement needs they had accumulated.[9] The amount of that unfunded backlog--the total backlog minus the funds available in replacement reserve accounts--averaged more than $1,400 per unit across the entire insured inventory.

Most properties have additional resources to help cover those requirements in the form of their annual net cash flows (revenues minus expenses). Nevertheless, for about 38 percent of all properties and more than half of the older assisted ones, those resources were not enough to cover both their repair backlogs and their operations, debt service, and other costs. For the most distressed projects in the assisted group as a whole, the average unfunded backlog amounted to more than $3,500 per unit. Eliminating the unfunded backlog for properties that lacked their own resources would require an estimated $1.3 billion for the entire FHA-insured inventory, including $1.1 billion for the assisted part.[10]

8. The estimates are based on Department of Housing and Urban Development, *Report to Congress on Alternative Methods for Funding Public Housing Modernization* (April 1990). The minimum estimate includes repair and replacement of existing architectural, mechanical, and electrical systems such as roofs, elevators, and paved areas. The maximum estimate includes the cost of needed additions or upgrades to bring projects up to code or ensure their long-term viability. Such items range from heavy-duty locks and energy-efficient windows to substantial structural changes in certain projects with serious design problems.

9. See Department of Housing and Urban Development, *Capital Needs Assessment: Multifamily Rental Housing with HUD-Insured (or -Held) Mortgages* (November 1992); and Abt Associates Inc., *Assessment of the HUD-Insured Multifamily Housing Stock: Final Report*, vol.1, *Current Status of HUD-Insured (or -Held) Multifamily Rental Housing* (prepared for the Department of Housing and Urban Development, September 1993).

10. CBO adjusted these figures downward somewhat to account for backlog needs that would probably be included in incentives for owners to keep their properties in assisted housing programs as discussed above. However, the estimates do not account for unfunded accrual needs because of a lack of information on those amounts.